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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-1483

FREDERICK M. FRIEDMAN,
Petitioner,

—against—

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONER, FREDERICK M. FRIEDMAN

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REPLY BRIEF FOR PETITIONER FREDERICK M. FRIEDMAN

Because the Government's opposing brief ignores several of the grounds advanced in the petition, inadequately responds to others, and ignores critical and undisputed findings of fact, petitioner herein respectfully replies to the Government's brief. The within brief will refer seriatim to the arguments raised in the petition.

1.

As to the conflict with *United States* v. *Rodman*, 519 F.2d 1058 (1st Cir. 1975).

Our petition (at p. 14-17) set forth the reasons why the purported "distinctions" which the Court of Appeals found to exist between this case and *Rodman* were in fact non-existent and why, upon analysis, those "distinctions" serve merely to highlight the irreconcilable conflict between the First Circuit's decision in *Rodman* and the Second Circuit's decision in this case. The Government's opposing brief (Br.* 13-14) merely restates the supposed "distinctions" relied upon by the Court of Appeals here, and fails even to address the petition's argument that those "distinctions" are in reality distinctions without a difference.

One factor in this regard is now noteworthy. The Solicitor General (at Br. 13) has now joined the District Court and the Court of Appeals in condemning** the out-

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* The letters "Br." followed by a number designate page references to the Government's brief in opposition to the petition for a writ of certiorari.

** The Solicitor General's condemnation, however, is unduly mild. The "misconduct" involved here was not merely "improper" (Br. 13) and did not result in a mere "misunderstanding" (Br. 14); rather, as set forth at pp. 7-12 of the petition, the Government's representatives engaged in a deliberate gross fraud replete with deceptions and concealments and, eventually, capped by perjury at the District Court hearing. Nor was the SEC attorney's affirmative misrepresentation that there would be no criminal reference, which is referred to at Br. 5-6, merely made to an irrelevant third party, as the Solicitor General's brief suggests, but was made to counsel for a prospective director of TDA who fully explained to the SEC attorney the tremendous significance of a truthful answer to the question involved (see petition at p. 10, ¶ 11).

rageous fraud perpetrated by the SEC attorneys on petitioner. Yet, petitioner is, in the Solicitor General's view, to be left without any remedy for this fraud perpetrated on him. The Solicitor General's suggestion (at Br. 14, n. 7) that the Court of Appeals "did not foreclose the possibility" of relief in the civil action is frivolous in view of the undisputed fact—so found by the District Court and unquestioned by the Government on appeal—that no such remedy is in reality a possibility (see petition p. 19, n. **).

Under these circumstances it is respectfully submitted that the District Court did not abuse its discretion* in reaching the sole result—dismissal of substantial portions of the indictment—which would in any respect have tended to remedy the wrong deliberately inflicted on petitioners by the Government's undisputed fraud.

2.

As to the importance of the question of the District Court's supervisory power to remedy a fraud perpetrated by Government attorneys upon a citizen.

The Government's brief fails to address this point directly. Rather, the Government states that review of this significant issue is premature since petitioner has not yet been tried (Br. 7-8). However, the Solicitor General does not dispute that Congress has mandated that review by

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* It should be borne in mind that the issue here presented is whether or not the District Court abused its discretion—as the Court of Appeals held it did—rather than, as the Solicitor General states, "whether the indictment *should have been* dismissed." (Br. 2; emphasis added).

this Court on certiorari at this stage of the proceedings is permissible, and that, therefore, this Court's jurisdiction has been properly invoked under 28 U.S.C. § 1254(1). The Solicitor General's analogy to the non-appealability of interlocutory orders is misplaced since Congress has declined to grant this Court jurisdiction at that procedural posture.

Thus, as recently as last term in *Adamo Wrecking Co.* v. *United States,* —— U.S. ——, 98 S.Ct. 566 (1978) (cited in the Petition (at pp. 39-40) but ignored in the Government's brief), this Court granted certiorari where, as here, dismissal of an indictment by a District Court was reversed and remanded for trial by the Court of Appeals. This case is in the identical procedural posture as *Adamo* was when this Court granted certiorari. See also *Mills* v. *Electric Auto-Light Co.,* 396 U.S. 375, 381, 90 S.Ct. 616, 620 (1970), where despite the reversal by the Court of Appeals and remand to the District Court for a trial, this Court stated, "We granted certiorari . . . believing that resolution of this basic issue should be made at this stage of the litigation and not postponed until after a trial under the Court of Appeals' decision." Indeed, in view of the gross fraud perpetrated on petitioner, to require him to withstand the rigors and tribulations of a criminal trial, if the District Court's dismissal of the indictment was not an abuse of discretion, would be a gross injustice.

3.

As to the SEC's unauthorized criminal reference of this case to the United States Attorney's office.

Subsequent to the filing of the Petition in this case, this Court rendered its decision in *United States* v. *Caceres,* No. 76-1309, 99 S.Ct. 1465 (April 2, 1979). Every factor—without exception—considered by this Court in *Caceres* in assessing the appropriate remedy for an administrative agency's failure to follow its administrative regulations warrants dismissal of the indictment here. The following were the factors held by this Court to be the relevant considerations in determining what, if any, remedy is appropriate in a criminal prosecution for an administrative non-prosecutorial agency's violation of its own regulations:

(a) In *Caceres,* "neither the Constitution nor any Act of Congress requires that official approval be secured . . ." (99 S.Ct. at 1467). In the instant case, to the contrary, regulations with respect to criminal references are dictated by federal statute (see e.g., 15 U.S.C. § 78d-1(a)).

(b) In *Caceres,* the agency's "construction of their own regulations, even if erroneous, was not obviously so." (99 S.Ct. at 1472). Here, the violation of the published regulations involved a gross, undisputed, and obvious fraud.

(c) In *Caceres,* the reason for the failure to follow administrative regulations was perceived to have been time pressures "rather than any doubt about [the agency's action's] propriety" (99 S.Ct. at 1472). Here, the failure to follow the administrative regulations was part and parcel of the SEC attorneys' fraudulent misconduct.

(d) In *Caceres*, "the Executive itself has provided for internal sanctions in cases of knowing violations of the . . . regulations" (99 S.Ct. at 1474). Here, not only is there no provision for internal sanctions, but the SEC itself has effectively advised that no sanctions will be imposed unless the courts do so* (see petition, p. 20).

(e) *Caceres* involved an "occasional erroneous administration" of the regulation (99 S.Ct. at 1474). Here, the Government has conceded that the failure to follow the administrative regulations regarding the making of criminal references is a routine and everyday deviation from the regulations.

(f) In *Caceres*, "the agency action, while later found to be in violation of the regulations, nonetheless reflected a reasonable, good-faith attempt to comply . . ." (99 S.Ct. at 1474). Here, the Government's actions were fraudulent rather than in good faith.

(g) In *Caceres* the defendant did not "suffer substantially because of [the regulations'] violations

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* The Solicitor General's statement (Br. 13, n. 5) that "both SEC lawyers have since resigned their positions with the Government" is misleading if it intends to convey that those resignations were in any manner related to the fraud in this case or were in any manner a result of any sanctions imposed by the SEC. One of the attorneys, Perlmutter, testified at the District Court hearing that he had left the SEC and had entered private practice prior to the hearing itself. There is nothing in the record regarding the circumstances under which the second attorney, Tucker, left the SEC (and the Government's brief indicates no record reference), but not even the Government's brief in its recitation of Tucker's resignation, even without record references, suggests that that resignation was in any way impelled by the SEC itself, or that the SEC regarded either resignation as having been made under circumstances other than highly honorable.

> by the agency", and "no one questions" that authorization would have been obtained (99 S.Ct. at 1372, 1474). Here, had the regulations been followed and the matter proceeded to the levels required prior to a criminal reference, nothing in the record indicates that the fraud perpetrated by the SEC attorneys on petitioner would have been consummated by their more experienced superiors.

Moreover, the Solicitor General's characterization of the regulations governing criminal references is inaccurate. As noted in the petition, the regulations authorize only the *Commission* to make a criminal reference. The regulations cited by the Solicitor General (at Br. 12, referring to Pet. App. 92a-94a) either require *Commission* authorization or contain delegations by the Commission to higher levels of authority than that of Messrs. Tucker and Perlmutter, who made the recommendations here. And as to the one regulation referred to in the Government's brief (at Br. 12) regarding inter-agency cooperation (§§ 171.06 and 171.07 of the Commission's Manual, set forth at Pet. App. 93a), such cooperation is sanctioned in matters "*other than* formal investigations which have been ordered by the Commission"—a proviso especially pertinent to this case where, as noted at pages 23-25 of the petition, there *was* a formal investigation (see Point 4 of petition).

4.

As to the Court of Appeals' ignoring of critical stipulated facts.

Significantly, the Government's brief fails to dispute—or even address—the fact that the Court of Appeals' decision in this case constitutes a sharp deviation from the rule invariably followed by every other federal Circuit Court of Appeals that an appellate court does not have the power to ignore and override critical facts which the parties have stipulated to and do not dispute even on appeal (indeed not even on this Petition). The Government apparently has no answer to Point 4 of the petition.

5.

The reversal of the dismissal of Counts 1-4 on alternative grounds.

The Government, just as does the Court of Appeals, aborts the District Court's decision dismissing Counts 1-3 by directing this Court's attention to a single basis upon which the District Court dismissed the counts, disregarding other basic and fundamental reasons. Lack of materiality of the non-disclosure of the ERD transactions was merely one basis for the District Court's dismissal. The District Court went further and held:

> "As defrauded *sellers* of securities, those shareholders are unfortunately not within the purview of Section 17. This is the dilemma which pervades the public offering counts of the indictment; the illegality charged is basically a Section 10(b) violation in that the injured parties were the deceived sellers of

> TDA stock. A prosecution for violation of that provision would appear to be barred by the statute of limitations, and consequently, the Government has attempted to resuscitate the ERD schemes by portraying them as acts in furtherance of a conspiracy. For the reasons just stated that approach is inappropriate, and the motion to dismiss the public offering counts for failure to state an offense is granted to the extent that the ERD transactions, portrayed in paragraphs 10(f) and 10(g), are stricken." (Pet. App. pp. 49a-50a)

Section 17(a) of the 1933 Act (whether conspiracy or substantive violation) generally speaking makes it unlawful in the offer and sale of securities by the use of the mails to employ a scheme or device to defraud a purchaser of the securities offered or sold. *United States* v. *Cashin,* 281 F.2d 669, 671-672 (2d Cir. 1969); *United States* v. *Amick,* 439 F.2d 351, 358 (7th Cir. 1971); *United States* v. *Saporta,* 270 F.Supp. 183, 185 (E.D.N.Y. 1967). To the extent that the indictment charged that the victim of the alleged fraud was ERD, the seller of the TDA securities, and that the offer and sale of the security involved in the alleged fraud occurred in April or May, 1971, but not in connection with the TDA offer and sale in November, 1971, it was insufficient, as the District Court held, to charge either a conspiracy to violate Section 17(a), or a substantive violation of 17(a), or a Section 1001 violation relating to said ERD transactions. The Court of Appeals was in error, we submit, and so was the Government in ignoring these basic insufficiencies in the indictment on which the District Court relied. The Government's position, as well as the Court of Appeals', is contrary to well-established judicial authority and the statutory purpose. The Government's argument justifies certiorari, not a denial.

The Government's position on the District Court's dismissal of Count 4 is even more surprising since the Government seeks to overcome troublesome judicial authority and legislative purpose by espousing a novel doctrine that "causation" is relevant only in civil actions for damages under Section 14(a) and Rule 14(a)-9 but irrelevant under criminal actions (Br. 11, n. 4).

This startling argument, which is relegated to a footnote, would eliminate from a criminal charge under Section 14(a) (although not in a civil case) the essential elements of Section 14(a) and Rule 14(a)-9. The Government cites no authority, which is not surprising, since judicial authority is all to the contrary. *SEC* v. *Joiner*, 320 U.S. 344, 355, 64 S.Ct. 120, 125 ("where this proof is offered in a civil action as here the preponderance of the evidence will establish the case; if it were offered in a criminal case, it would have to meet the stricter requirement of satisfying the jury beyond a reasonable doubt"); *Mallis* v. *Federal Deposit Ins. Corp.*, 568 F.2d 824, 829 (2d Cir. 1977), *cert. dis. Bankers Trust Co.* v. *Mallis*, 98 S.Ct. 1117 ("The fact that *Gentile* was a criminal case in which civil standing was not an issue does not diminish its persuasion as a precedent with respect to the Section 10(b) claim before us. The existence of a 'sale' is as essential to a criminal prosecution for violation of Section 17(a) as it is to a civil action under that section. We find no basis on the face of either the 1933 Act or the 1934 Act of denominating a pledge as a 'sale' for criminal but not for civil purposes"). This Court made no such distinction in *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); *Mills* v. *Electric Auto-Light Co.*, 396 U.S. 375 (1970); and *TSC Industries* v. *Northway*, 426 U.S. 438 (1976). What was held by this Court to be essential in order to constitute a violation of Section 14(a) and Rule 14(a)-9 was that "the proxy solicitation itself was an essential link in the

accomplishment of the transactions". *Mills* v. *Electric Auto-Light Co.*, 396 U.S. *supra* at 385. Based on those decisions as well as substantial other judicial authority (cited in the petition, pp. 36-39), the District Court was plainly correct in dismissing Count 4 because, as it held, ". . . none of the [alleged illegal] acts, all of which had been accomplished prior to the stockholders' meeting referred to in the TDA proxy solicitation, bore any direct relationship to the business sought to be accomplished at the meeting, and referred to in the proxy statement. Accordingly, direct 'transaction causation' resulting from the nondisclosure of those prior acts cannot be demonstrated."

Unless this Court grants certiorari, the Court of Appeals' decision will emasculate the requirements of a charge under Section 17(a), and will broaden and extend its scope beyond the intent of Congress and contrary to decisions of this Court and the weight of judicial authority.

Finally, the Government urges the correctness of the Court of Appeals' decision in reversing the dismissal of Count 4 with respect to an alleged violation of Item 7(f) of Schedule 14(a), which requires disclosure in a proxy of a transaction with "any of its subsidiaries" in which a director or an officer had a direct or indirect material interest. The Government contends, as did the Court of Appeals, that the "Westcalind kickback transaction had to be disclosed under this standard", because Westcalind was a subsidiary of TDA (Br. 3, 11). The District Court found as a fact, however, that TDA owned only 34% of the stock of Westcalind which it held as an investment, that Westcalind's operations were not consolidated with TDA's for financial reporting purposes, and that under SEC rules consolidation of TDA's and West-

calind's operations would have been improper "since TDA owned less than a majority of Westcalind's outstanding stock" (App. 77a). Not a shred of evidence to the contrary was adduced by the Government in the District Court or in the Court of Appeals. In no way, therefore, would Proxy Rule 7(f) of Schedule 14(a) support the correctness of the Court of Appeals' decision as urged by the Government. In disregarding the District Court's findings of fact and conclusions of law that prove conclusively Westcalind was not a subsidiary of TDA, the Court of Appeals and the Government would sustain a charge of crime for an alleged non-disclosure in the proxy statement of alleged improper acts which are clearly not within the purview of Item 7(f) of Schedule 14(a) (issued pursuant to Section 14(a) of the Securities Act).

In addition to the foregoing, petitioner respectfully adopts all arguments contained in the brief of co-petitioner Fields.

CONCLUSION

For the above reasons and for the reasons set forth in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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